

Moscow Financial Weekly

For the weeks ending April 11 and 18, 2003
Treasury Attache's office, U.S. Embassy Moscow

Highlights

- Macro indicators for first quarter show continued growth
- Deposit insurance bill voted out of committee -- first reading expected soon

Key Economic Indicators

Indicators	Level	% chg 1 week	% chg since Jan. 1
Ruble/\$ (MICEX) UTS	R31.1925	-0.30	-1.86
Monetary Base*	R967.1 bln	3.16%	2.85**
CPI	NA	NA	5.2
International Reserves*	\$57.6 bln	3.23	20.76
RTS Index (end of week)	402.86	7.80	12.20%
Refinancing rate	18	0	-3

*For week prior

** % chg from the abnormally high seasonal level at the end of the year.

Economic Developments

According to Goskomstat, **industrial production** growth has continued through March, led primarily by export industries. Last month, production was up by 11.4% m-o-m and by 6.7% y-o-y, compared to 4.9% and 6.5% y-o-y in January and February, respectively. The cold winter also contributed to an increase in metals production and to growth in the electricity energy industry. Taking into the account a fall of 0.2% in 2002 in this sector, electricity is well on the way to recovery this year. Although production growth in industries serving the domestic market lag behind, there is a potential bright spot in pharmaceutical production, which increased by 10.7% y-o-y last quarter. Gains in industrial production in March made up a large share of the overall figure for the quarter: 6% y-o-y for 1Q03, compared to 2.6% y-o-y growth during the same period last year.

Not surprisingly, Goskomstat also reported that **real incomes** have increased by 16.3% y-o-y and 5.6% m-o-m, while real wages were up by 11.4% y-o-y and 7.9% m-o-m in March, which will continue to fuel consumption-led growth. At the same time, Prime Minister Kasyanov announced last week that the **GDP growth** totaled 6.4% during the first quarter of 2003, stating that the increased prices for the exports gave a considerable contribution to such an impressive result. Such positive dynamics lead most analysts to conclude that the government's 2003 GDP growth target of 4.5% can be easily reached or even exceeded.

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The CBR also announced a **trade surplus** of \$12.5 billion for the first quarter of 2003, combined with strong inflows to the capital account (companies have borrowed \$2.2 billion from overseas markets in the first quarter alone), produced a balance of payments surplus of \$7.6 billion. With the budget currently in surplus as well, excess BoP surplus is causing a dramatic increase in reserves in the first quarter, despite heavy foreign debt payments in February. Some analysts note that capital flight has slowed slightly in the first quarter, but estimate that it is currently running at an annualized rate of 6% of GDP (\$21 billion) similar to estimates for last year which used the same methodology.

Following the announcement of Standard and Poors (See Financial Weekly ending March 28 and April 4th), the Fitch agency has declared its plans to upgrade Russia's **sovereign rating**. Its group of experts is in Moscow consulting with representatives of the CBR and the government. Currently, the rating is at "BB-" with a positive outlook, which will likely be raised to "BB" positive outlook in two weeks. The Russian government has been criticized for the slowing structural and institutional reforms; however, the recent adoption of laws on the RAO UES restructuring seemed to be a key development which encouraged rating agencies to act now. Market players view this as a positive sign, but as it was already factored into current yields, Eurobond prices will not be affected by these decisions.

The government's **financial reserve** increased in the first quarter of 2003 from R200 billion to R230 billion (or by \$7.4 billion). Given the large debt payments this quarter, the growth in the reserve means that fiscal policy is still tight. Finance Minister Kudrin last week noted that a legislative proposal on the stabilization fund would be ready for government review before the May holidays.

Deputy Finance Minister Kolotukhin announced that the **FTO debt swap** would continue in July 2003, with \$481 million available for swap, of which \$250 million has already been reconciled. The government also plans to swap International Investment Bank and International Bank for Economic Cooperation debt (worth \$1.1 billion) at that time as well, which would mark the completion of settlement of Russia's private sector Soviet-era debt. Kolotukhin also mentioned plans to finalize settlement of **former Yugoslav** trade debt later this year. The successor states would be paid \$800 million on former Soviet debt of 1.2 billion clearing dollars (at an exchange rate of 0.625 USD for 1 clearing dollar).

Banking sector

On April 14 the Committee on Credit Organizations and Financial Markets voted to recommend that the Duma pass in first reading the **deposit insurance bill** submitted by the GOR with one amendment: government guarantees on Sberbank deposits should be lifted not from January 1, 2007, but only after Sberbank's share in the total volume of private deposits stays under 30% for 6 months in a row. The first reading was tentatively scheduled for April 25, but has been pushed back again until possibly May 14.

Effective April 15, **MICEX** started trading dollars for rubles with next day delivery (T+1) in the MICEX UTS and the CBR now sets the official exchange rate for the next date equal to the weighted average rate in that trading. The CBR said the new mechanism for setting the official rate is better because the average rate in "tom" trading is more representative since short-term market conditions, in particular immediate liquidity of authorized banks, have less impact on it.

Gennady Melikyan, formerly Sberbank Deputy Chairman, on the first week of April replaced Andrei Vinogradov at the post of **CBR Main Inspectorate Head** and later was appointed CBR Deputy Chairman as well.

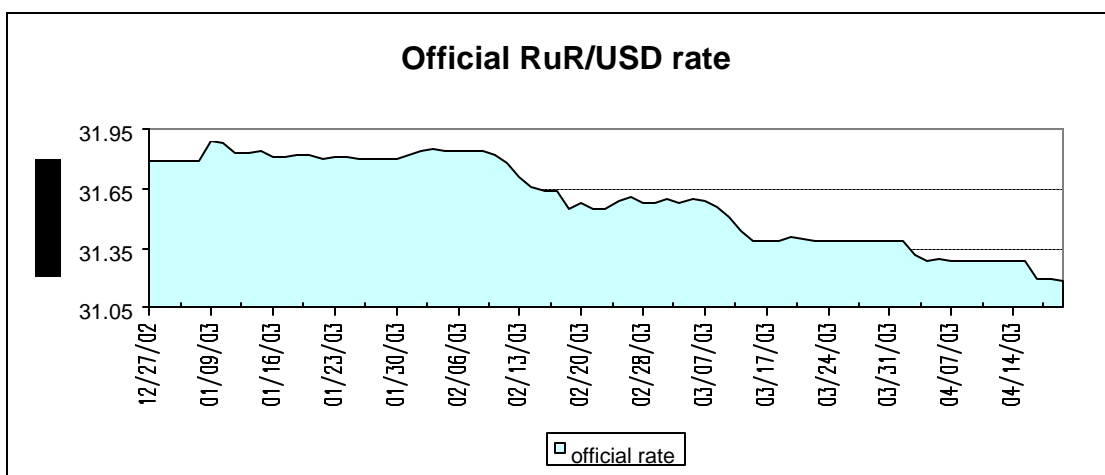
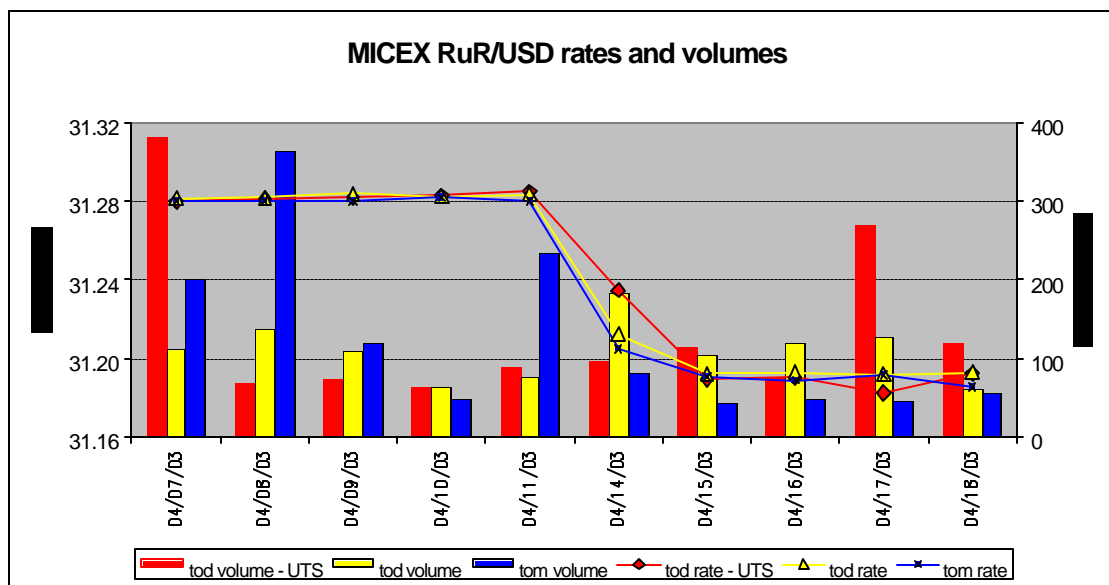
On April 15, Viktor Zubkov, Chief of the Committee for Financial Monitoring, noted to the press that approximately six or seven criminal cases connected with **money laundering** have been filed, and that soon they will be reviewed by the procuracy. He noted that these cases are against both legal entities and private persons. In 2002, it passed 60 possible cases of money laundering to law enforcement, and in the first quarter of 2003, it has already passed another 60 cases, he said. A FATF mutual evaluation team is now in Moscow reviewing compliance with FATF rules, with a view to possible Russian membership in the organization in June.

Financial markets

Forex Market

During the week of April 7 the dollar remained very steady against the ruble due to CBR's support at R31.28/\$, the same level since April 1 afternoon. Next Monday, April 14, the CBR abandoned the market and the dollar immediately slid 5 kopeks in the UTS and went on weakening until the next day the CBR returned to the market with a bid at R31.19/\$.

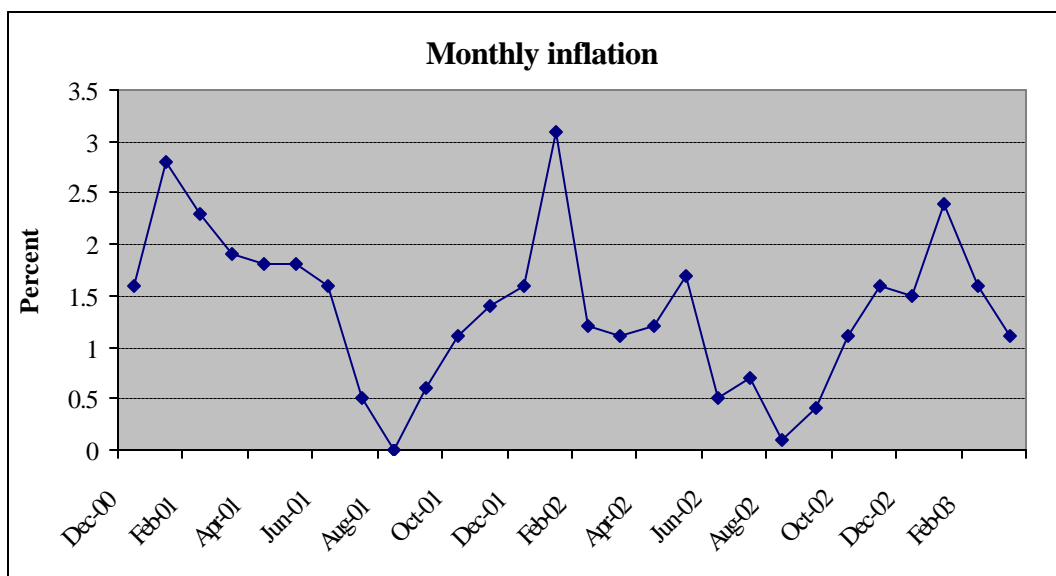
For the week of April 7 the dollar inched up 0.01% against the ruble, closing in the UTS on Friday, April 11 at R31.2849/\$. MICEX weekly trade volumes were \$676.66 million, \$498.02 million and \$965.19 million for the morning (UTS), afternoon "tod" and "tom" sessions, respectively. For the week of April 14 the dollar weakened 0.30%, closing in the UTS on April 18 at R31.1925/\$. MICEX weekly trade volumes were \$679.21 million, \$597.91 million and \$277.67 million for the morning (UTS), afternoon "tod" and "tom" sessions, respectively. The new UTS-tom session introduced on April 15, which is now used to determine the official exchange rate, saw very modest volumes, not exceeding \$17 million.



Prices

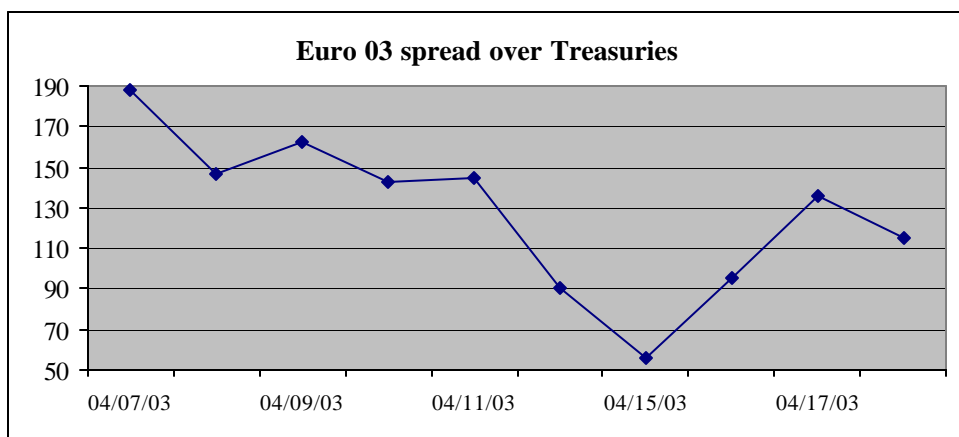
According to First Deputy Minister Aleksey Ulykaev, inflation should not exceed 1% in April, and that therefore the annual target of 10-12% would be achieved. At the same time, the First Deputy Chairman of the CBR Oleg Vuygin claimed that inflation would be up at 13-13.5% for the year unless a policy response is taken soon. As inflation is expected to accelerate due to the pass-through effects of higher oil prices during the Gulf War (the GOR printed rubles to buy excess dollars generated from increased exports), such measures would need to be implemented quite soon. So far this year, CPI growth has been attributed primarily to increases in service tariffs. Goskomstat reported that PPI

for March y-o-y was 19.7%, up from 19.2% in February, ostensibly due to higher prices in oil and power sectors.

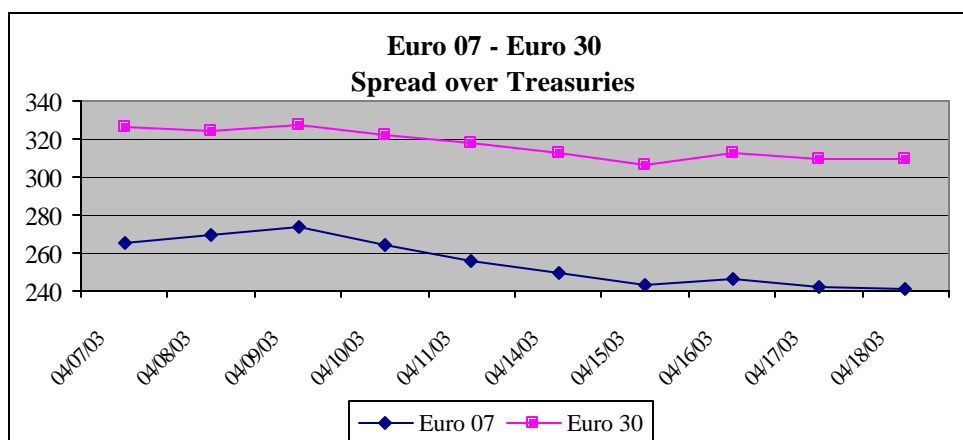


Eurobonds

The Russian Eurobond market was relatively calm during the first week observed. Most issues finished the week on somewhat the same levels, however, already next week, the market soared to a new highs. The top-gainer was the most liquid Russian paper Euro-30, reaching all-time maximum of 88 ¼ par last week. The most demand came from the Russian players due to the increased ruble liquidity in the local banking system.



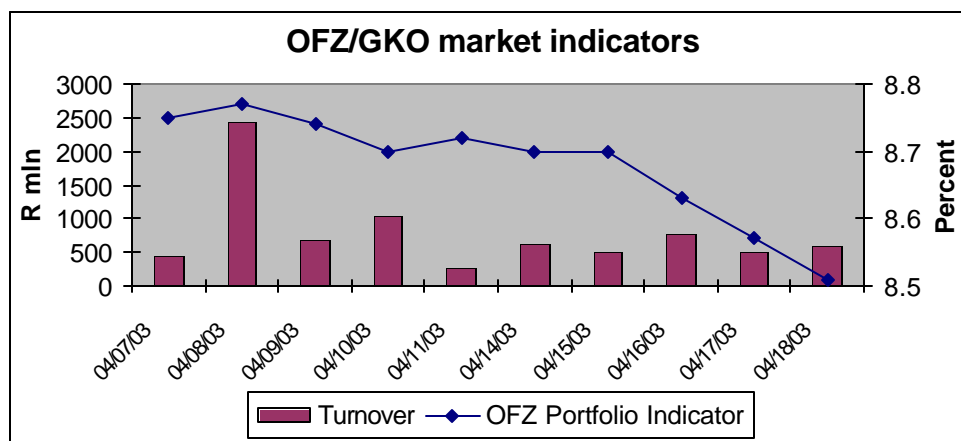
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Interest/Bond Market

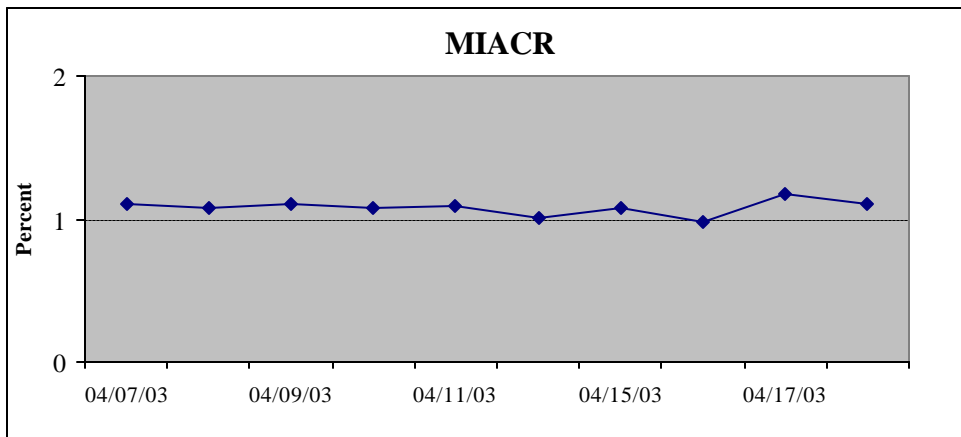
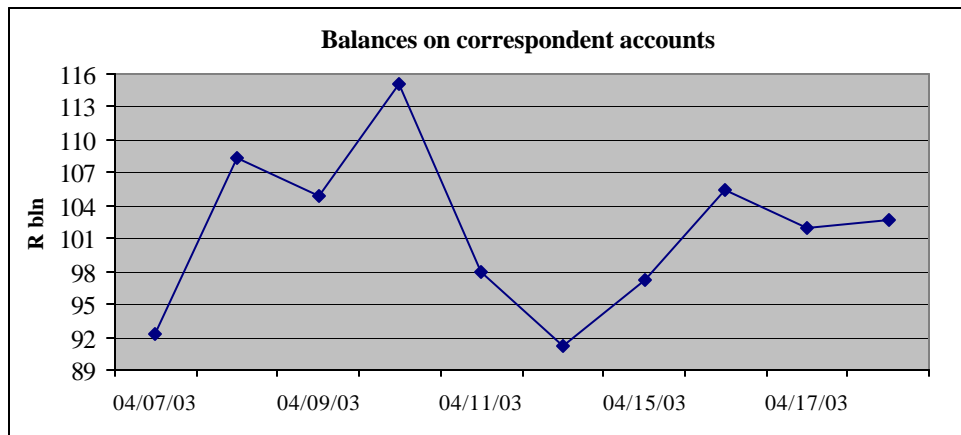
Bonds/Bills

During the first week observed, the secondary OFZ/GKO market was quiet in terms of yields fluctuation. The yields dropped below 9% p.a. during the first week of April and market players decided to stay on sidelines while the factor of high ruble liquidity was still present in the banking system. Last week, the situation changed and the prices began to grow slowly on low volumes. The most demanded papers were middle-term, while the longest-term papers were able to pierce down through the 9% level.



Overnight rates

The balances on banks' correspondent accounts were fluctuating in a wide range of R91-115 billion, however, these are the levels high enough to keep the interbank ruble rates non-precedently low.

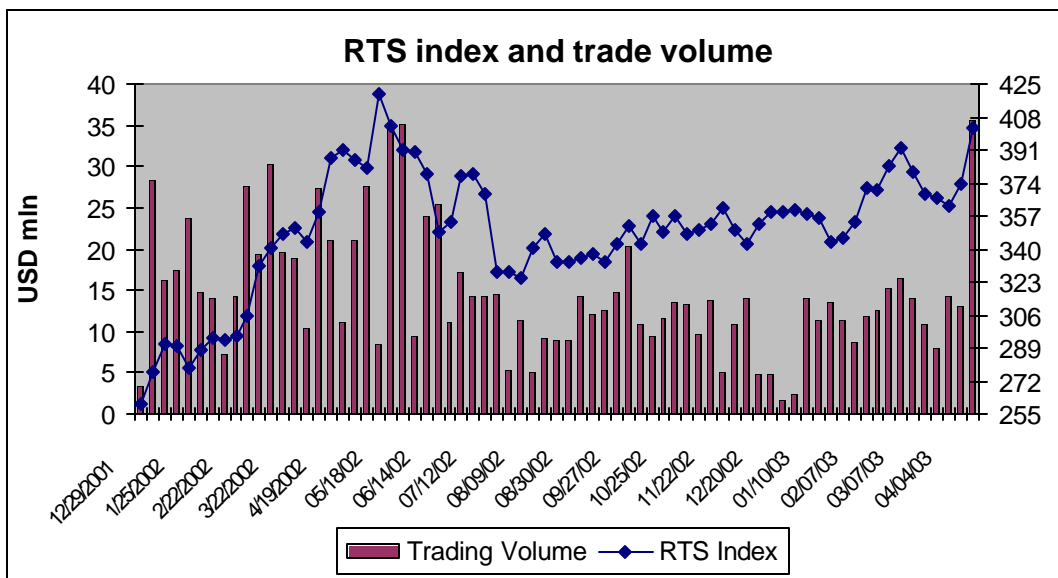
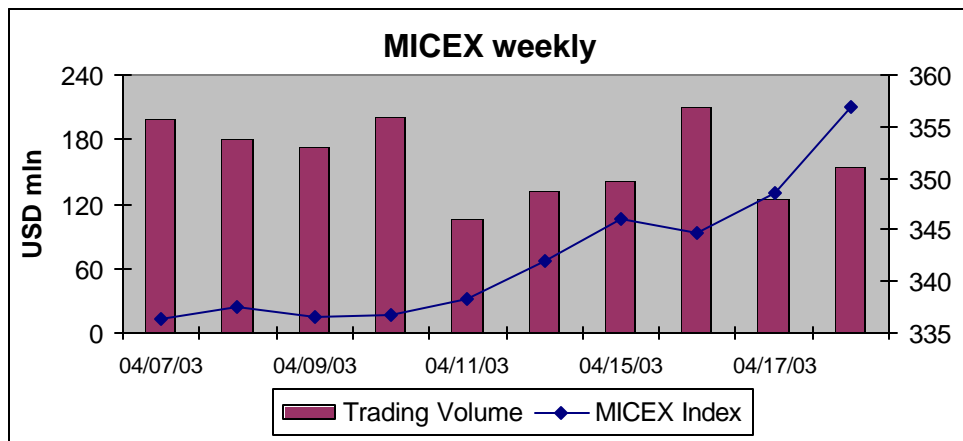
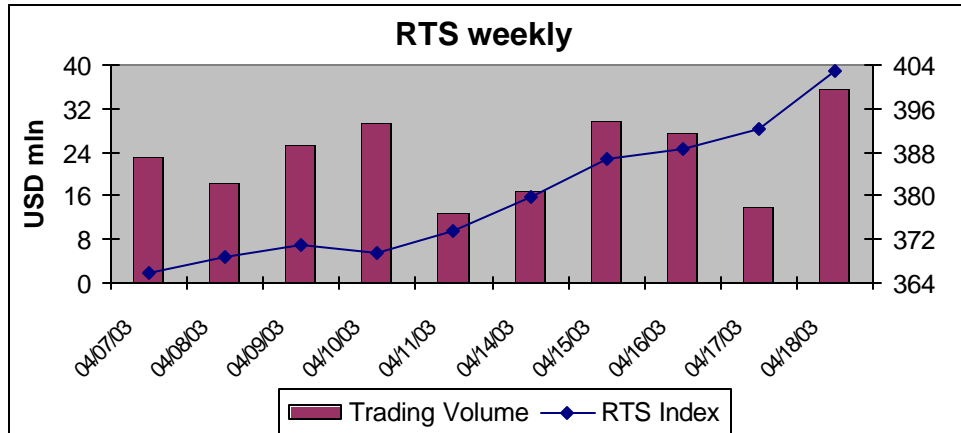


Stock Market

After falling for the 4 weeks in March and the beginning of April, the RTS index soared during the two weeks observed. During the first week, the index was up by 3.18% on the considerably increased volumes. The leaders of growth were the shares of Surgut, Sibneft and Gazprom, while Mosenergo shares were behind the market after increasing substantially during the previous weeks which was explained by the approaching ex-dividend date. Last week, the RTS index was up by 7.8% already with the trade volumes remaining on high levels. The growth was mainly due to the demand for oil shares. Surgut was up by 23.7%, Yukos – by 10%, LUKoil – by 8.9%, while Mosenergo shares were falling again followed by the RAO UES papers. The market currently is in the strong rally, with the RTS index finishing last week above 400 level, for the first time since May of last year.

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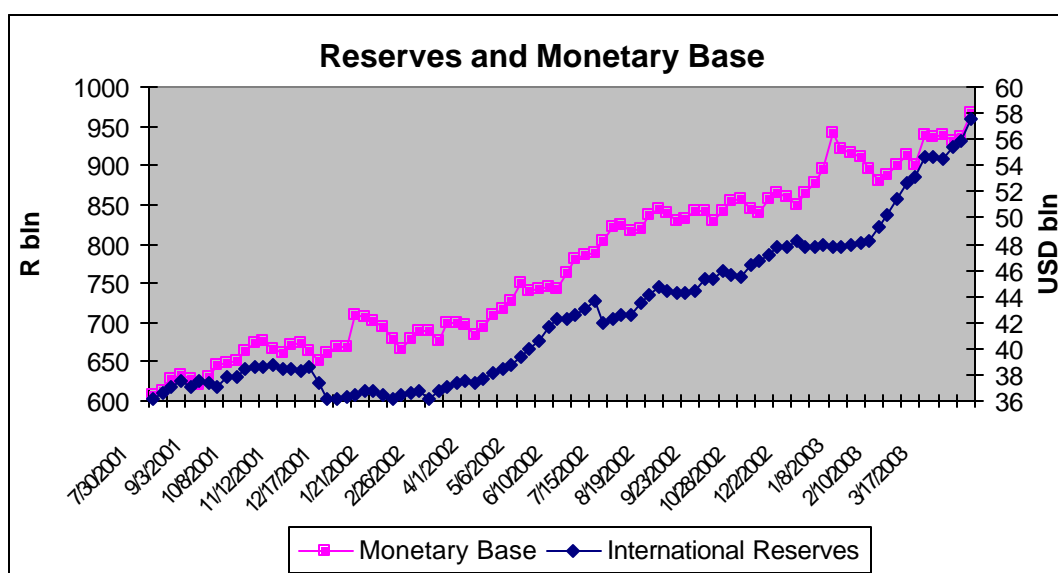


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International Reserves and Monetary Base

The CBR's international reserves continued to grow during the weeks ending April 4th and 11th. During the first week observed, reserves were modestly up by \$400 million; however, next week they leaped up by as much as \$1.8 billion to an all time high of \$57.6 billion. Reserves growth continues to be supported by current account and budget surpluses, caused by high oil prices and tight fiscal policy. Recently, world commodity prices fell, which should indicate a future decline in the growth of reserves in approximately 2-2.5 month's time (the lag between exporting and returning the proceeds.)

The monetary base has been rising as well during the two week period, reaching the maximum level of R967.1 billion as of April 14, 2003. This is R26.8 billion higher than in the beginning of the year: the first time this year when the monetary base actually exceeded the seasonally high level early in January. The base was up by as much as R29.6 billion (approximately \$1 billion) during a single week.



EXPLANATORY NOTES

1. **EXCHANGE RATES:** SELT - "System of Electronic Lot (currency) trading" -- a computer based OTC-style trading system organized by the Moscow Interbank Currency Exchange (MICEX). MICEX Unified Trading Session (UTS) is the one in which exporters have to sell 50% of the repatriated currency. UTS "tom" weighted average becomes the "official" exchange rate for the next day. "\$-tod" price is the price of the dollar with same day delivery. "\$-tom" is the price of the dollar with delivery on the next day. Minimum lot size for each of the dollar instruments is \$100,000. Average price is quoted as the weighted average of all actual deals entered into the system by various banks.

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2. INTEREST RATES: Moscow InterBank Actual Credit Rate is calculated as the average-weighted rate on the volume of actual transactions in interbank loans by commercial banks.

3. STOCK INDICES: The RTS index is the only official indicator of the Russian Trading System. It is calculated every 30 minutes of the RTS trade session, starting at 12:00. It comprises 60 shares of 35 leading companies. These shares are included in so-called Category "A" listings. The index indicates over-the-counter stock prices. The index represents the ratio of the total market capitalization of the shares of the companies selected for the index to the total market capitalization of the same shares as of the initial date multiplied by the index value as of the initial date (31 December 1997) using a base of 100 beginning September 1, 1995. The ruble-adjusted index is a derivative of the main dollar index, using the same base. The MICEX index is calculated by the stock section of the Moscow Interbank Currency Exchange and is based on the price fluctuations of 17 shares of the MICEX's first and second listings.

4. INTERNATIONAL RESERVES OF THE RUSSIAN FEDERATION represent the amount of reserve assets of the Bank of Russia and Finance Ministry. Those reserve assets are comprised of monetary gold, special drawing rights, the reserve position in the IMF and other liquid foreign assets. The latter include short-term deposits in non-resident and resident banks, balances in current accounts, foreign government securities, repo agreements with these securities made with non-residents, and other liquid assets (accrued interest on these assets is not included). Monetary gold is evaluated at a floating rate, revised periodically, but not always reported immediately. Foreign currency assets are converted into U.S. dollars on the basis of the cross rates of foreign currencies to the dollar, calculated using the official rates of the ruble to these foreign currencies, as set by the CBR.

5. MONETARY BASE (M1) is comprised of cash and reserves of commercial banks on deposit in the CBR. It is the basic part of the money supply (M2).

6. LOMBARD CREDITS, distributed through auctions, are aimed to provide liquidity to the banking sector. These credits are extended to banks on the basis of collateral.